



**[BILLING CODE: 6750-01S]**

**FEDERAL TRADE COMMISSION**

**[File No. 112 3108]**

**Apple Inc.; Analysis of Proposed Consent Order to Aid Public Comment**

**AGENCY:** Federal Trade Commission.

**ACTION:** Proposed Consent Agreement.

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**SUMMARY:** The consent agreement in this matter settles alleged violations of federal law prohibiting unfair or deceptive acts or practices or unfair methods of competition. The attached Analysis of Proposed Consent Order to Aid Public Comment describes both the allegations in the draft complaint and the terms of the consent order -- embodied in the consent agreement -- that would settle these allegations.

**DATES:** Comments must be received on or before February 14, 2014.

**ADDRESSES:** Interested parties may file a comment at

<https://ftcpublic.commentworks.com/ftc/appleconsent> online or on paper, by following the instructions in the Request for Comment part of the **SUPPLEMENTARY INFORMATION** section below. Write "Apple Inc. - Consent Agreement; File No. 112 3108" on your comment and file your comment online at

<https://ftcpublic.commentworks.com/ftc/appleconsenthttps://ftcpublic.commentworks.com/ftc/fidelitynationalconsent>

by following the instructions on the web-based form. If you prefer to file your comment on paper, mail or deliver your comment to the following address: Federal Trade Commission,

Office of the Secretary, Room H-113 (Annex D), 600 Pennsylvania Avenue, NW, Washington, DC 20580.

**FOR FURTHER INFORMATION CONTACT:** Duane Pozza, Bureau of Consumer Protection, (202-326-2042), 600 Pennsylvania Avenue, NW, Washington, DC 20580.

**SUPPLEMENTARY INFORMATION:** Pursuant to Section 6(f) of the Federal Trade Commission Act, 15 U.S.C. 46(f), and FTC Rule 2.34, 16 CFR 2.34, notice is hereby given that the above-captioned consent agreement containing consent order to cease and desist, having been filed with and accepted, subject to final approval, by the Commission, has been placed on the public record for a period of thirty (30) days. The following Analysis to Aid Public Comment describes the terms of the consent agreement, and the allegations in the complaint. An electronic copy of the full text of the consent agreement package can be obtained from the FTC Home Page (for January 15, 2014), on the World Wide Web, at <http://www.ftc.gov/os/actions.shtm>. A paper copy can be obtained from the FTC Public Reference Room, Room 130-H, 600 Pennsylvania Avenue, NW, Washington, D.C. 20580, either in person or by calling (202) 326-2222.

You can file a comment online or on paper. For the Commission to consider your comment, we must receive it on or before February 14, 2014. Write "Apple Inc. - Consent Agreement; File No. 112 3108" on your comment. Your comment - including your name and your state - will be placed on the public record of this proceeding, including, to the extent practicable, on the public Commission Website, at <http://www.ftc.gov/os/publiccomments.shtm>.

As a matter of discretion, the Commission tries to remove individuals' home contact information from comments before placing them on the Commission Website.

Because your comment will be made public, you are solely responsible for making sure that your comment does not include any sensitive personal information, like anyone's Social Security number, date of birth, driver's license number or other state identification number or foreign country equivalent, passport number, financial account number, or credit or debit card number. You are also solely responsible for making sure that your comment does not include any sensitive health information, like medical records or other individually identifiable health information. In addition, do not include any "[t]rade secret or any commercial or financial information which . . . is privileged or confidential," as discussed in Section 6(f) of the FTC Act, 15 U.S.C. § 46(f), and FTC Rule 4.10(a)(2), 16 CFR 4.10(a)(2). In particular, do not include competitively sensitive information such as costs, sales statistics, inventories, formulas, patterns, devices, manufacturing processes, or customer names.

If you want the Commission to give your comment confidential treatment, you must file it in paper form, with a request for confidential treatment, and you have to follow the procedure explained in FTC Rule 4.9(c), 16 CFR 4.9(c).<sup>1</sup> Your comment will be kept confidential only if the FTC General Counsel, in his or her sole discretion, grants your request in accordance with the law and the public interest.

Postal mail addressed to the Commission is subject to delay due to heightened security screening. As a result, we encourage you to submit your comments online. To make sure that the Commission considers your online comment, you must file it at <https://ftcpublic.commentworks.com/ftc/appleconsent> by following the instructions on the web-

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<sup>1</sup> In particular, the written request for confidential treatment that accompanies the comment must include the factual and legal basis for the request, and must identify the specific portions of the comment to be withheld from the public record. *See* FTC Rule 4.9(c), 16 CFR 4.9(c).

based form. If this Notice appears at <http://www.regulations.gov/#!home>, you also may file a comment through that website.

If you file your comment on paper, write “Apple Inc. - Consent Agreement; File No. 112 3108” on your comment and on the envelope, and mail or deliver it to the following address: Federal Trade Commission, Office of the Secretary, Room H-113 (Annex D), 600 Pennsylvania Avenue, NW, Washington, DC 20580. If possible, submit your paper comment to the Commission by courier or overnight service.

Visit the Commission Website at <http://www.ftc.gov> to read this Notice and the news release describing it. The FTC Act and other laws that the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments that it receives on or before February 14, 2014. You can find more information, including routine uses permitted by the Privacy Act, in the Commission’s privacy policy, at <http://www.ftc.gov/ftc/privacy.htm>.

### **Analysis of Proposed Consent Order to Aid Public Comment**

The Federal Trade Commission (“Commission”) has accepted, subject to final approval, an agreement containing a consent order from Apple Inc. (“Apple”).

The proposed consent order has been placed on the public record for thirty (30) days for receipt of comments by interested persons. Comments received during this period will become part of the public record. After thirty (30) days, the Commission will again review the agreement and the comments received, and will decide whether it should withdraw from the agreement and take appropriate action or make final the agreement’s proposed order.

Apple bills consumers for charges related to activity within software applications (“apps”) that consumers download to their iPhone, iPod Touch, or iPad devices from Apple’s App Store. This matter concerns Apple’s billing for charges incurred by children in apps that are likely to be used by children without having obtained the account holders’ express informed consent.

The Commission’s proposed complaint alleges that Apple offers thousands of apps, including games that children are likely to play, and that in many instances, children can obtain virtual items within a game app that cost money. Apple bills parents and other adult account holders for items that cost money within an app—“in-app charges.” In connection with billing for children’s in-app charges, Apple sometimes requests a parent’s iTunes password. In many instances, Apple “caches” (that is, stores) the iTunes password for fifteen minutes after it is entered. During this process, Apple in many instances has not informed account holders that password entry will approve a charge or initiate a fifteen-minute window during which children using the app can incur charges without further action by the account holder. The Commission’s proposed complaint alleges that, through these practices, Apple often fails to obtain parents’ informed consent to charges incurred by children, which constitutes an unfair practice under Section 5 of the FTC Act.

The proposed order contains provisions designed to prevent Apple from engaging in the same or similar acts or practices in the future. Part I of the proposed order requires Apple to obtain express, informed consent to in-app charges before billing for such charges, and to allow consumers to revoke consent to prospective in-app charges at any time. As defined in the proposed order, express, informed consent requires an affirmative act communicating authorization of an in-app charge (such as entering a password), made proximate to both an in-

app activity for which Apple is billing a charge and a clear and conspicuous disclosure of material information about the charge. Under the definition, the act and disclosure must be reasonably calculated to ensure that the person providing consent is the account holder (as opposed to the child). The proposed order would require the disclosure to appear at least once per mobile device. Apple must come into compliance with the Part I requirements by March 31, 2014.

Part II of the proposed order requires Apple to provide full refunds to Apple account holders who have been billed by Apple for unauthorized in-app charges incurred by minors. Apple will refund no less than \$32.5 million for these in-app charges in the year following entry of the order, and if such refunds total less than \$32.5 million, Apple will remit any remaining balance to the Commission to be used for informational remedies, further redress, or payment to the U.S. Treasury as equitable disgorgement. To effectuate refunds, Apple must send an electronic notice to its consumers that clearly and conspicuously discloses the availability of refunds and instructions on how to obtain such refunds. Within 30 days of the end of the one-year redress period, Apple must provide the Commission with records of refund requests, refunds paid, and any refunds denied.

Parts III through VII of the proposed order are reporting and compliance provisions. Part III of the proposed order requires Apple to maintain and upon request make available certain compliance-related records, including certain consumer complaints and refund requests, for a period of five years. Part IV is an order distribution provision that requires Apple to provide the order to current and future principals, officers, and corporate directors, as well as current and future managers, employees, agents, and representatives who participate in certain duties related

to the subject matter of the proposed complaint and order, and to secure statements acknowledging receipt of the order.

Part V requires Apple to notify the Commission of corporate changes that may affect compliance obligations within 14 days of such a change. Part VI requires Apple to submit a compliance report 90 days after March 31, 2014, the date by which Apple is required to come into full compliance with Part I of the order. It also requires Apple to submit additional compliance reports within 10 business days of a written request by the Commission. Part VII is a provision “sunsetting” the order after twenty (20) years, with certain exceptions.

The purpose of this analysis is to aid public comment on the proposed order. It is not intended to constitute an official interpretation of the complaint or proposed order, or to modify in any way the proposed order’s terms.

By direction of the Commission, Commissioner Wright dissenting.

Donald S. Clark,  
Secretary.

#### **Statement of Chairwoman Edith Ramirez and Commissioner Julie Brill**

The Commission has issued a complaint and proposed consent order to resolve allegations that Apple Inc. unfairly failed to obtain informed consent for charges incurred by children in connection with their use of mobile apps on Apple devices in violation of Section 5 of the Federal Trade Commission Act. Consistent with prior application of the Commission’s unfairness authority, our action today reaffirms that companies may not charge consumers for purchases that are unauthorized – a principle that applies regardless of whether consumers are in

a retail store, on a website accessed from a desktop computer, or in a digital store using a mobile device.

As alleged in the Commission’s complaint, Apple violated this basic principle by failing to inform parents that, by entering a password, they were permitting a charge for virtual goods or currency to be used by their child in playing a children’s app and at the same time triggering a 15-minute window during which their child could make unlimited additional purchases without further parental action. As a consequence, at least tens of thousands of parents have incurred millions of dollars in unauthorized charges that they could not readily have avoided. Apple, however, could have prevented these unwanted purchases by including a few words on an existing prompt, without disrupting the in-app user experience. As explained below, we believe the Commission’s allegations are more than sufficient to satisfy the standard governing the FTC Act’s prohibition against “unfair acts or practices.”

## **I. Overview of In-App Purchases on Apple Mobile Devices**

Apple distributes apps, including games, that are likely to be used by children on Apple mobile devices through its iTunes App Store. While playing these games, kids may incur charges for the purchase of virtual items such as digital goods or currency (known as “in-app charges”) at prices ranging from \$.99 to \$99.99. These in-app charges are billed to their parents’ iTunes accounts. Apple retains thirty percent of the revenues from in-app charges. As part of the in-app purchasing process, Apple displays a general prompt that calls for entry of the password for the iTunes account associated with the mobile device. Apple treats this password entry as authorizing a specific transaction and simultaneously allowing additional in-app purchases for 15 minutes.



While key aspects of the in-app purchasing sequence have changed over time, as described in the Commission's complaint, one constant has been that Apple does not explain to parents that entry of their password authorizes an in-app purchase and also opens a 15-minute window during which children are free to incur unlimited additional charges. We allege that, since at least March 2011, tens of thousands of consumers have complained about millions of dollars in unauthorized in-app purchases by children, with many of them individually reporting hundreds to thousands of dollars in such charges. As a result, we have reason to believe, and have alleged in our complaint, that Apple's failure to disclose the 15-minute window is an unfair practice that violates Section 5 because it has caused or is likely to cause substantial consumer injury that is neither reasonably avoidable by consumers nor outweighed by countervailing benefits to consumers or competition.<sup>1</sup>

The proposed consent order resolves these allegations by requiring Apple to obtain informed consent to in-app charges. The order also requires Apple to provide full refunds, an amount no less than \$32.5 million, to all of its account holders who have been billed for unauthorized in-app charges incurred by minors.<sup>2</sup>

## **II. Application of the Unfairness Standard**

Importantly, the Commission does not challenge Apple's use of a 15-minute purchasing window in apps used by kids. Rather, our charge is that, even after receiving at least tens of thousands of complaints about unauthorized charges relating to in-app purchases by kids, Apple continued to fail to disclose to parents and other Apple account holders that entry of a password

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<sup>1</sup> 15 U.S.C. § 45(n).

in a children's app meant they were approving a single in-app charge plus 15 minutes of further, unlimited charges.

In asserting that Apple violated Section 5's prohibition against unfair practices by failing to obtain express informed consent for in-app charges incurred by kids, we follow a long line of FTC cases establishing that the imposition of unauthorized charges is an unfair act or practice.<sup>3</sup> This basic tenet applies regardless of the technology or platform used to bill consumers and regardless of whether a company engages in deliberate fraud. Indeed, there is nothing in the unfairness authority we have been granted by Congress or in the Commission's Unfairness Policy Statement to suggest that our power is in any way constrained or should be applied differently depending on the technology or platform at issue, or the intentions of the accused party.<sup>4</sup>

Our task here, as in all instances in which we assert jurisdiction over unfair acts or practices, is to determine whether the alleged unlawful conduct causes or is likely to cause substantial injury that is not reasonably avoidable by consumers and is not outweighed by countervailing benefits to consumers or competition. After a full investigation, we have reason to believe that Apple's conduct constitutes an unfair practice.

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<sup>2</sup> Any sum below \$32.5 million that is not returned to account holders is to be paid to the FTC.

<sup>3</sup> See, e.g., *FTC v. Willms*, No. 2:11-CV-828 MJP, 2011 WL 4103542, at \*9 (W.D. Wash. Sept. 13, 2011); *FTC v. Inc21.com Corp.*, 745 F. Supp. 2d 975 (N.D. Cal. 2010), *aff'd*, 475 Fed. Appx. 106 (9th Cir. Mar. 30, 2012); *FTC v. Crescent Publ'g Grp., Inc.*, 129 F. Supp. 2d 311, 322 (S.D.N.Y. 2001); see also Complaint, *FTC v. Jesta Digital, LLC*, No. 1:13-cv-01272 (D.D.C. filed Aug. 20, 2013).

<sup>4</sup> The FTC need not prove intent to establish a violation of the FTC Act. See, e.g., *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1368 (11th Cir. 1988); **Federal Trade Commission Policy Statement on Unfairness**, appended to *Int'l Harvester Co.*, 104 F.T.C. 949, 1070 (1984) ("FTC Unfairness Statement").

### **A. Substantial Injury to Consumers**

We begin by addressing the issue of harm. It is well established that substantial injury may be demonstrated by a showing of either small harm to a large number of people or large harm in the aggregate.<sup>5</sup> Both are present here. As alleged in the complaint, in many individual instances, Apple customers paid hundreds of dollars in unauthorized charges while thousands of others incurred lower charges that together totaled large sums. We allege that, in the aggregate, at least tens of thousands of consumers have complained of millions of dollars of unauthorized in-app charges by children. Moreover, we have reason to believe that, for a variety of reasons, many more affected customers never complained. Some, for example, were undoubtedly deterred by Apple's stated policy that all App Store transactions are final. Others who incurred low charges likely did not protest because of the relatively small dollar value at issue. Indeed, extensive Commission experience teaches that consumer complaints typically represent only a small fraction of actual consumer injury.<sup>6</sup>

In his dissent, Commissioner Wright expresses the view that the harm alleged by the Commission involves "a miniscule percentage of consumers" and is therefore insubstantial.<sup>7</sup> We respectfully disagree. We find it of little consequence that the number of complainants is a small fraction of all app downloads, as Commissioner Wright asserts.<sup>8</sup> As an initial matter, our

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<sup>5</sup> See *FTC v. Neovi, Inc.*, 604 F.3d 1150, 1157 (9th Cir. 2010), *amended*, 2010 WL 2365956 (9th Cir. June 15, 2010); *Orkin*, 849 F.2d at 1365; FTC Unfairness Statement n.12.

<sup>6</sup> Likewise, there is research indicating consumers do not register the vast majority of their complaints about problems with goods and services. See Amy J. Schmitz, *Access to Consumer Remedies in the Squeaky Wheel System*, 39 PEPP. L. REV. 279, 286 (2012).

<sup>7</sup> Dissenting Statement of Commissioner Joshua D. Wright ("Wright Dissent") at 1.

<sup>8</sup> See *id.* at 6.

complaint focuses on conduct affecting Apple account holders whose children may unwittingly incur in-app charges in games likely to be played by kids. The proportion of complaints about children's in-app purchases as compared to total app downloads, revenue from the sale of Apple mobile devices, or Apple's total sales revenue sheds no light on the extent of harm alleged in this case. More fundamentally, the FTC Act does not give a company with a vast user base and product offerings license to injure large numbers of consumers or inflict millions of dollars of harm merely because the injury affects a small percentage of its customers or relates to a fraction of its product offerings.

It is also incorrect that "in order to qualify as substantial, the harm must be large compared to any offsetting benefits."<sup>9</sup> This conflates the third prong of the unfairness test, calling for a weighing of countervailing benefits against the relevant harm, with the substantial injury requirement. As shown above, the allegations in the complaint are more than sufficient to establish substantial injury.<sup>10</sup>

## **B. Injury Not Reasonably Avoidable by Consumers**

We also have reason to believe that consumers could not reasonably avoid the alleged injury. An injury is not reasonably preventable by consumers unless they had an opportunity to

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<sup>9</sup> *Id.* (citation and internal quotation marks omitted).

<sup>10</sup> See, e.g., *Orkin*, 849 F.2d at 1365 (substantial injury demonstrated by small injury to large number of customers); *FTC v. Neovi, Inc.*, 598 F. Supp. 2d 1104, 1115 (S.D. Cal. 2008) (substantial consumer injury resulted from unauthorized charges to tens of thousands of consumers), *aff'd*, 604 F.3d 1150 (9th Cir. 2010); *FTC v. Global Mktg. Group, Inc.*, 594 F. Supp. 2d 1281, 1288-89 (M.D. Fla. 2008) (millions of dollars in unlawful charges demonstrated substantial injury); *FTC v. Windward Mktg., Inc.*, No. 1:96-CV-615F, 1997 WL 33642380, at \*11 (N.D. Ga. Sept. 30, 1997) (harm to large number of consumers sufficient to establish substantial injury).

make a “free and informed choice” to avoid the harm.<sup>11</sup> Before billing parents for in-app charges by children, Apple presented parents with a generic password prompt devoid of any explanation that password entry approves a single charge as well as all charges within the 15 minutes to follow. We do not think parents acted unreasonably by not averting harm from a 15-minute window that was not disclosed to them. Consumers cannot avoid or protect themselves from a practice of which they are not made aware, and companies like Apple cannot impose on consumers the responsibility for ferreting out material aspects of payment systems, as FTC enforcement actions in a variety of contexts make clear.<sup>12</sup> Apple’s disclosure of the 15-minute window in its Terms and Conditions was not sufficient to provide consumers with adequate notice.

Over time, through experience, some parents may infer that entry of a password opens a 15-minute window during which unlimited purchases can be made. The receipt of an invoice with unauthorized charges may be sufficient to alert some parents about the unwanted charges. But that does not relieve Apple of the obligation to take reasonable steps to inform consumers of the 15-minute window before the user opens that window and before Apple places charges on a bill. In light of Apple’s failure to disclose the 15-minute purchasing window, it was reasonable for parents not to expect that when they input their iTunes password they were authorizing 15 minutes of unlimited purchases without the child having to ask the parent to input the password

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<sup>11</sup> *Neovi*, 598 F. Supp. 2d at 1115.

<sup>12</sup> See, e.g., *Facebook, Inc.*, No. C-4365, at 4 (F.T.C. July 27, 2012) (consent order) (requiring “clear and prominent” disclosure of certain information material to privacy protections “separate and apart from” the detailed privacy policy or terms of use); *Google Inc.*, No.C-4336, at 3-4 (F.T.C. Oct. 13, 2011) (consent order) (setting similar requirements).

again. There was nothing to suggest this and thus no “obligation for them to investigate further” as Commissioner Wright suggests.<sup>13</sup>

### **C. Injury Not Outweighed by Benefits to Consumers or Competition**

Finally, we also have reason to believe that the harm alleged outweighs any countervailing benefits to consumers or competition from Apple’s practices. This is not a case about Apple’s “choice to integrate the fifteen-minute window into Apple users’ experience on the platform,” as Commissioner Wright implies.<sup>14</sup> What is at issue is Apple’s failure to disclose the 15-minute window to parents and other account holders in connection with children’s apps, not Apple’s use of a 15-minute window as part of the in-app purchasing sequence.

Under the proposed consent order, Apple is permitted to bill for multiple charges within a 15-minute window upon password entry provided it informs consumers what they are authorizing, allowing consumers to make an informed choice about whether to open a period during which additional charges can be incurred without further entry of a password.<sup>15</sup> The order gives Apple full discretion to determine how to provide this disclosure. But we note that the information called for, while important, can be conveyed through a few words on an existing prompt. The burden, if any, to users who have never had unauthorized charges for in-app purchases, or to Apple, from the provision of this additional information is *de minimis*.<sup>16</sup> Nor do

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<sup>13</sup> Wright Dissent at 10.

<sup>14</sup> *Id.* at 4.

<sup>15</sup> See Proposed Order ¶¶ 3, 5 (defining “Clear and Conspicuous” and “Express, Informed Consent”).

<sup>16</sup> For this reason alone, it was unnecessary for the Commission to undertake a study of how consumers react to different disclosures before issuing its complaint against Apple, as Commissioner Wright suggests. We also note that the Commission need only determine that it has a “reason to believe” that there has been an FTC Act violation in order to issue a complaint. 15 U.S.C. § 45(b).

we believe the required disclosure would detract in any material way from a streamlined and seamless user experience. In our view, the absence of such minimal, though essential, information does not constitute an offsetting benefit to Apple's users that even comes close to outweighing the substantial injury the Commission has identified.

Moreover, we are confident that our action today fully preserves the incentive to innovate and develop digital platforms that are user-friendly and beneficial for consumers. In this respect, we emphasize that we do not expect companies "to anticipate *all* things that might go wrong" when designing a complicated platform or product.<sup>17</sup> Our action against Apple is based on its failure to provide any meaningful disclosures about the 15-minute window in the purchase sequence, despite receiving at least tens of thousands of complaints about unauthorized in-app purchases by children and despite having the issue flagged in high-profile media reports in late 2010 and early 2011.<sup>18</sup> We recognize that Apple did make certain changes to its in-app purchase sequence in an attempt to resolve the issue. Most notably, Apple added a password prompt to the in-app purchase sequence in March 2011. But for well over two-and-a-half years after that point, the password prompt has lacked any information to signal that the account holder is about to open a 15-minute window in which unlimited charges could be made in a children's app.

The extent and duration of the unauthorized in-app charges alleged in the complaint support our conclusion that, while Apple has strong incentives to cultivate customer goodwill in order to encourage the purchase of in-app goods and currency and promote the sale of its mobile

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<sup>17</sup> Wright Dissent at 15 (emphasis in original).

<sup>18</sup> See, e.g., Cecilia Kang, *In-app purchases in iPad, iPhone, iPod kids' games touch off parental firestorm*, WASH. POST, Feb. 8, 2011, available at <http://www.washingtonpost.com/wp-dyn/content/article/2011/02/07/AR2011020706073.html>; Associated Press, *Apple App Store:*

devices, these incentives may not be sufficient to produce the necessary disclosures. Because customers are often unaware of the way in-app charges work, let alone the possibility of Apple disclosing its practices, we do not think that Commissioner Wright's belief that Apple "has more than enough incentives to disclose"<sup>19</sup> is justified. Indeed, his argument appears to presuppose that a sufficient number of Apple customers will respond to the lack of adequate information by leaving Apple for other companies. But customers cannot switch suppliers easily or quickly. Mobile phone and data contracts typically last two years, with a penalty for early termination. In addition, the time and effort required to learn another company's operating system and features, not to mention the general inertia often observed for consumers with plans for cellular, data, and Internet services, could very well mean that Apple customers may not be as responsive to Apple's disclosure policies as seems to be envisioned by Commissioner Wright.

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We applaud the innovation that is occurring in the mobile arena. Today, parents have access to an enormous number and variety of apps for use by their children. We firmly believe that technological innovation and fundamental consumer protections can coexist and, in fact, are mutually beneficial. Such innovation is enhanced, and will only reach its full potential, if all marketplace participants abide by the basic principle that they must obtain consumers' informed consent to charges before they are imposed.

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*Catnip for Free-Spending Kids?*, CBS NEWS, Dec. 9, 2010, available at <http://www.cbsnews.com/news/apple-app-store-catnip-for-free-spending-kids/>.

<sup>19</sup> Wright Dissent at 14.



## **Statement of Commissioner Maureen K. Ohlhausen**

I voted to accept for public comment the accompanying proposed administrative complaint and consent order, settling allegations that Apple Inc. engaged in unfair acts or practices by billing iTunes account holders for charges incurred by children in apps that are likely to be used by children without the account holders' express informed consent.<sup>1</sup> I write separately to emphasize that our action today is consistent with the fundamental principle that any commercial entity, before billing customers, has an obligation to notify such customers of what they may be charged for and when, a principle that applies even to reputable and highly successful companies that offer many popular products and services.

In his dissent, Commissioner Wright lauds the iterative software design process of rapid prototyping, release, and revision based on market feedback; this approach has proven to be one of the most successful methods for balancing design tradeoffs. He also notes that it can be difficult to forecast problems that may arise with complicated products across millions of users and expresses concern that our decision today requires companies to anticipate and fix all such problems in advance.

I agree with Commissioner Wright that we should avoid actions that would chill an iterative approach to software development or that would unduly burden the creation of complex products by imposing an obligation to foresee all problems that may arise in a widely-used product.<sup>2</sup> I do not believe, however, that today's action implicates such concerns. First, Apple's

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<sup>1</sup> For the reasons given in the Statement of Chairwoman Ramirez and Commissioner Brill, I believe the complaint meets the requirements of 15 U.S.C. § 45(n) and the Commission's Unfairness Statement.

<sup>2</sup> I am concerned about any action that this agency takes that is likely to have adverse effects on firms' incentives to innovate. For example, in the antitrust context, I voted against the

iterative approach was not the cause of the harm the complaint challenges. In fact, Apple's iterative approach should have made it easier for the company to update its design in the face of heavy consumer complaints. Second, we are not penalizing Apple for failing to have anticipated every potential issue in its complex platform.<sup>3</sup> The complaint challenges only one billing issue of which Apple became well aware but failed to address in subsequent design iterations. By March 2011, consumers had submitted more than ten thousand complaints to Apple stating that its billing platform for in-app purchases for children's apps was failing to inform them about what they were being billed for and when. Although Apple adjusted certain screens in response and offered refunds, it still failed to notify account holders that by entering their password they were initiating a fifteen-minute window during which children using the app could incur charges without further action by the account holder. Even if Apple chose to forgo providing this information—the type of information that is critical for any billing platform, no matter how innovative, to provide—in favor of what it believed was a smoother user experience for some

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Commission's complaints in *Bosch* and *Google/MMI* based in significant part on my concern that those enforcement actions would hamper intellectual property rights and innovation more generally. See *In re* Motorola Mobility LLC & Google Inc., FTC File No. 121-0120, Dissenting Statement of Commissioner Maureen K. Ohlhausen (Jan. 3, 2013), available at <http://www.ftc.gov/sites/default/files/documents/cases/2013/01/130103googlemotorolaohlhausenstmt.pdf>; *In re* Robert Bosch GmbH, FTC File No. 121-0081, Statement of Commissioner Maureen K. Ohlhausen (Nov. 26, 2012), available at <http://www.ftc.gov/sites/default/files/documents/cases/2013/04/121126boschohlhausenstatement.pdf>.

<sup>3</sup> The complaint challenges harm that occurred since March 2011, after Apple changed its process to require the entry of the account holder's iTunes password before incurring any in-app charges immediately after installation. Previously, the entry of the password to install an app also opened a fifteen-minute window during which charges could be incurred without again entering a password.

users, the result was unfair to the thousands of consumers who subsequently experienced unauthorized in-app charges totaling millions of dollars.<sup>4</sup>

Commissioner Wright also argues that under our unfairness authority “substantiality is analyzed relative to the magnitude of any offsetting benefits,”<sup>5</sup> and concludes that compared to Apple’s total sales or in-app sales, injury was not substantial and that any injury that did occur is outweighed by the benefits to consumers and competition of Apple’s overall platform. The relevant statutory provision focuses on the substantial injury caused by an individual act or practice, which we must then weigh against countervailing benefits to consumers or competition from that act or practice.<sup>6</sup> Thus, we first examine whether the harm caused by the practice of not clearly disclosing the fifteen-minute purchase window is substantial and then compare that harm

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<sup>4</sup> It is also important to note that the Commission’s proposed order does not prohibit the use of the fifteen-minute window nor require that the account holder input a password for each purchase.

<sup>5</sup> Dissenting Statement of Commissioner Joshua D. Wright at 5.

<sup>6</sup> “The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.” 15 U.S.C. § 45(n).

to any benefits from that particular practice, namely the benefits to consumers and competition of not having a clear and conspicuous disclosure of the fifteen-minute billing window. It is not appropriate, however, to compare the injury caused by Apple's lack of clear disclosure with the benefits of the entire Apple mobile device ecosystem. To do so implies that all of the benefits of Apple products are contingent on Apple's decision not to provide a clear disclosure of the fifteen-minute purchase window for in-app purchases. Such an approach would skew the balancing test for unfairness and improperly compare injury "oranges" from an individual practice with overall "Apple" ecosystem benefits.

### **Dissenting Statement of Commissioner Joshua D. Wright**

Today, through the issuance of an administrative complaint, the Commission alleges that Apple, Inc. ("Apple") has engaged in "unfair acts or practices" by billing parents and other iTunes account holders for the activities of children who were engaging with software applications ("apps") likely to be used by children that had been downloaded onto Apple mobile devices.<sup>1</sup> In particular, the Commission takes issue with a product feature of Apple's platform that opens a fifteen-minute period during which a user does not need to re-enter a billing password after completing a first transaction with the password.<sup>2</sup> Because Apple does not expressly inform account holders that the entry of a password upon the first transaction triggers the fifteen-minute window during which users can make additional purchases without once again

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<sup>1</sup> Complaint, Apple, Inc., FTC File No. 1123108, at para. 28-30 (Jan. 15, 2014) [hereinafter *Apple Complaint*].

<sup>2</sup> As indicated in the complaint, initially the fifteen-minute window was triggered when an app was downloaded. *Id.* at para. 16. Apple changed the interface in March 2011 and subsequently the fifteen-minute window was triggered upon the first in-app purchase. *Id.* at para. 17. *See also infra* note 13.

entering the password, the Commission has charged that Apple bills parents and other iTunes account holders for the activities of children without obtaining express informed consent.<sup>3</sup>

Today's action has been characterized as nothing more than a reaffirmance of the concept that "companies may not charge consumers for purchases that are unauthorized."<sup>4</sup> I respectfully disagree. This is a case involving a miniscule percentage of consumers – the parents of children who made purchases ostensibly without their authorization or knowledge. There is no disagreement that the overwhelming majority of consumers use the very same mechanism to make purchases and that those charges are properly authorized. The injury in this case is limited to an extremely small – and arguably, diminishing – subset of consumers. The Commission, under the rubric of "unfair acts and practices," substitutes its own judgment for a private firm's decisions as to how to design its product to satisfy as many users as possible, and requires a company to revamp an otherwise indisputably legitimate business practice. Given the apparent benefits to some consumers and to competition from Apple's allegedly unfair practices, I believe the Commission should have conducted a much more robust analysis to determine whether the injury to this small group of consumers justifies the finding of unfairness and the imposition of a remedy.

Section 5 of the FTC Act prohibits, in part, "unfair . . . acts or practices in or affecting commerce."<sup>5</sup> As set forth in Section 5(n), in order for an act or practice to be deemed unfair, it must "cause[] or [be] likely to cause substantial injury to consumers which is not reasonably

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<sup>3</sup> *Apple Complaint*, *supra* note 1, at para. 4, 20, 28.

<sup>4</sup> Statement of Chairwoman Ramirez and Commissioner Brill at 1.

<sup>5</sup> 15 U.S.C. § 45(a).

avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or competition.”<sup>6</sup>

The test the Commission uses to evaluate whether an unfair act or practice is unfair used to be different. Previously the Commission considered: whether the practice injured consumers; whether it violated established public policy; and whether it was unethical or unscrupulous.<sup>7</sup> Only after an aggressive enforcement initiative that culminated in a temporary rulemaking suspension and Congressional threats of stripping the Commission of its unfairness authority altogether, was the current iteration of the unfairness test reached.<sup>8</sup> Importantly, this articulation, as set forth in the FTC Policy Statement on Unfairness (“Unfairness Statement”), not only requires that the alleged injury be substantial, it also includes the critical requirements that such injury “must not be outweighed by any countervailing benefits to consumers or competition that the practice produces” and “it must be an injury that consumers themselves could not reasonably have avoided.”<sup>9</sup>

As set forth in more detail below, I do not believe the Commission has met its burden to satisfy all three requirements in the unfairness analysis. In particular, although Apple’s allegedly unfair act or practice has harmed some consumers, I do not believe the Commission has demonstrated the injury is substantial. More importantly, any injury to consumers flowing from

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<sup>6</sup> 15 U.S.C. § 45(n).

<sup>7</sup> FTC Policy Statement on Unfairness, *appended to* Int’l Harvester Co., 104 F.T.C. 949, 1070 (1984), available at <http://www.ftc.gov/ftc-policy-statement-on-unfairness> [hereinafter *Unfairness Statement*].

<sup>8</sup> ABA SECTION OF ANTITRUST LAW, CONSUMER PROTECTION LAW DEVELOPMENTS, 57-59 (2009); J. Howard Beales, III, Director, Bureau of Consumer Protection, Fed. Trade Comm’n, The FTC’s Use of Unfairness Authority: Its Rise, Fall, and Resurrection at 9 (May 2003), available at <http://www.ftc.gov/public-statements/2003/05/ftcs-use-unfairness-authority-its-rise-fall-and-resurrection> [hereinafter *Beales’ Unfairness Speech*].

<sup>9</sup> *Unfairness Statement*, *supra* note 7, at 1073.

Apple's choice of disclosure and billing practices is outweighed considerably by the benefits to competition and to consumers that flow from the same practice. Accordingly, I respectfully dissent from the issuance of this administrative complaint and consent order.

### **Introduction**

This case requires the Commission to analyze consumer injury under the unfairness theory in a novel context: an allegation of a failure to disclose a product feature to consumers that results in some injury to one group of consumers but that generates benefits for another group.

The circumstances surrounding Apple's decision to forgo disclosing during the transaction the fifteen-minute window to its users – and according to the Commission's complaint, thereby failing to obtain express informed consent – are distinguishable from any other prior Commission case alleging unfairness. The economic consequences of the allegedly unfair act or practice in this case – a product design decision that benefits some consumers and harms others – also differ significantly from those in the Commission's previous unfairness cases.

The Commission commonly brings unfairness cases alleging failure to obtain express informed consent. These cases invariably involve conduct where the defendant has intentionally obscured the fact that consumers would be billed. Many of these cases involve unauthorized billing or cramming – the outright fraudulent use of payment information.<sup>10</sup> Other cases involve conduct just shy of complete fraud – the consumer may have agreed to one transaction but the

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<sup>10</sup> See, e.g., Complaint at 6, *FTC v. Jesta Digital, LLC*, Civ. No. 1:13-cv-01272 (D.D.C. Aug. 20, 2013) (alleging that “Jesta charged consumers who did not click on the subscribe button and charged consumers for products they did not order.”); Complaint, *FTC v. Wise Media, LLC*, Civ. No. 1:13-CV-1234 (N.D. Ga. Apr. 16, 2013) (alleging that defendants charge consumers for purported services without consumers ever knowingly signing up for such services).

defendant charges the consumer for additional, improperly disclosed items.<sup>11</sup> Under this scenario, the allegedly unfair act or practice injures consumers and does not provide economic value to consumers or competition. In such cases, the requirement to provide adequate disclosure itself does not cause significant harmful effects and can be satisfied at low cost.

However, the particular facts of this case differ in several respects from the above scenario. First, there is no evidence Apple intended to harm consumers by not disclosing the fifteen-minute window.<sup>12</sup> For example, when Apple began receiving complaints about children making unauthorized in-app purchases on their parents' iTunes accounts, the company took steps to address the problem.<sup>13</sup> In addition, Apple has an established relationship with its customers and its business model depends upon customer satisfaction and repeat business.

Second, rather than an unscrupulous or questionable practice, the nature of Apple's disclosures on its platform is an important attribute of Apple's platform that affects the demand for and consumer benefits derived from Apple devices and services. Disclosures made on the screen while consumers interact with mobile devices are a fundamental part of the user

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<sup>11</sup> Complaint at 15-16, *FTC v. JAB Ventures, LLC*, Civ No. CV08-04648 (RZx) (C.D. Cal. July 8, 2008) (alleging unauthorized billing when defendants charged consumers who had cancelled their enrollment or who had not been adequately informed about negative option features); *FTC v. Crescent Publ'g Group, Inc.*, 129 F. Supp. 2d 311 (S.D.N.Y. 2001) (pornography website failing to disclose the point at which a "free tour" ended and a monthly membership would begin).

<sup>12</sup> By distinguishing the facts of this case from other unfairness cases brought by the Commission alleging the failure to obtain express informed consent, I do not imply that intent is a required element of the analysis. However, I think drawing the distinction informs the discussion. Furthermore, I am unaware that the Commission has ever exercised its unfairness authority where it has alleged only that the defendant inadvertently charged consumers.

<sup>13</sup> See Chris Foresman, *Apple facing class-action lawsuit over kids' in-app purchases*, arstechnica, Apr. 15, 2011, <http://arstechnica.com/apple/2011/04/apple-facing-class-action-lawsuit-over-kids-in-app-purchases/> ("After entering a password to purchase an app from the



experience for products like mobile computing devices. It is well known that Apple invests considerable resources in its product design and functionality.<sup>14</sup> In streamlining disclosures on its platform and in its choice to integrate the fifteen-minute window into Apple users' experience on the platform, Apple has apparently determined that most consumers do not want to experience excessive disclosures or to be inconvenienced by having to enter their passwords every time they make a purchase.

The Commission has long recognized that in utilizing its authority to deem an act or practice as "unfair" it must undertake a much more rigorous analysis than is necessary under a deception theory.<sup>15</sup> As a former Bureau Director has noted, "the primary difference between full-blown unfairness analysis and deception analysis is that deception does not ask about offsetting benefits. Instead, it presumes that false or misleading statements either have no

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App Store, the password now has to be reentered in order to make any initial in-app purchases.").

<sup>14</sup> Nigel Hollis, *The Secret to Apple's Marketing Genius (Hint: It's Not Marketing)*, The Atlantic, July 11, 2011, <http://www.theatlantic.com/business/archive/2011/07/the-secret-to-apples-marketing-genius-hint-its-not-marketing/241724/> (in discussing Apple's functionality, "[u]sing an Apple product feels so natural, so intuitive, so transparent, that sometimes, even people paid to know what makes products great completely miss the cause of their addiction to Apple products. It's the natural, intuitive transparency of the technology. The superlative product experience comes from an unusual combination of human and technical understanding, and it creates the foundation of all the other positive aspects of the brand."); Peter Eckert, *Dollars And Sense: The Business Case For Investing In UI Design*, Fast Company, Mar. 15, 2012, <http://www.fastcodesign.com/1669283/dollars-and-sense-the-business-case-for-investing-in-ui-design> ("As we have seen with Apple's success, creating products that offer as much simplicity as functionality drives market share and premium pricing."). See also Neil Hughes, *Apple's research & development costs ballooned 32% in 2013 to \$4.5B*, Apple Insider, Oct. 30, 2013, <http://appleinsider.com/articles/13/10/30/apples-research-development-costs-ballooned-32-in-2013-to-45b>; Cliff Kuang, *The Six Pillars of Steve Jobs' Design Philosophy*, Fast Company, Nov. 7, 2011, <http://www.fastcodesign.com/1665375/the-6-pillars-of-steve-jobs-design-philosophy>.

<sup>15</sup> Int'l Harvester Co., 104 F.T.C. 949, 1070 (1984); *Beales' Unfairness Speech*, *supra* note 8, § III.

benefits, or that the injury they cause consumers can be avoided by the company at very low cost.”<sup>16</sup> It is also well established that one of the primary benefits of performing a cost-benefit analysis is to ensure that government action does more good than harm.<sup>17</sup> The discussion below explains why I believe the Commission’s action today fails to satisfy the elements of the unfairness framework and thereby conclude that placing Apple under a twenty-year order in a marketplace in which consumer preferences and technology are rapidly changing is very likely to do more harm to consumers than it is to protect them.

**I. The Evidence Does Not Support a Finding of Substantial Injury as Required by the Unfairness Analysis**

Apple’s choice to include the fifteen-minute window in its platform design, and its decision on how to disclose this window, resulted in harm to a small fraction of consumers. Any consumer harm is limited to parents who incurred in-app charges that would have been avoided had Apple instead designed its platform to provide specific disclosures about the fifteen-minute window for apps with in-app purchasing capability that are likely to be used by children. That harm to some consumers results from a design choice for a platform used by millions of users with disparate preferences is not surprising. The failure to provide perfect information to consumers will always result in “some” injury to consumers. The relevant inquiry is whether the injury to the subset of consumers is “substantial” as contemplated by the Commission’s unfairness analysis. Consumer injury may be established by demonstrating the allegedly unfair act or practice causes “a very severe harm to a small number”<sup>18</sup> of people or “a small harm to a

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<sup>16</sup> *Beales’ Unfairness Speech*, *supra* note 8, § III.

<sup>17</sup> Int’l Harvester, 104 F.T.C. at 1070.

<sup>18</sup> Int’l Harvester, 104 F.T.C. at 1064.

large number of people.”<sup>19</sup> While it is possible to demonstrate substantial injury occurred as a result of an act or practice causing a small harm to a large number of consumers, substantiality is analyzed relative to the magnitude of any offsetting benefits.<sup>20</sup> This is particularly critical when the allegedly unfair practice is not a fraudulent activity such as unauthorized billing or cramming, where there are no offsetting benefits.

By reasonable measures of the potential harms and benefits available to the Commission, the injury is relatively small and not necessarily substantial in this case. The complaint alleges Apple has received “at least tens of thousands of complaints related to unauthorized in-app charges by children”<sup>21</sup> while playing games acquired on Apple’s platform, which supports all music, books, and applications purchased for use with Apple mobile devices (e.g., iPhone, iPad, iPod, hereinafter “iDevices”). Although “tens of thousands” sounds like a large number, the unfairness inquiry requires this number be evaluated in an appropriate context. Apple announced its 50 billionth app download in May 2013.<sup>22</sup> Even 200,000 complaints in 50 billion downloads would represent only four complaints in a million, which is quite a small fraction.

In addition, the complaint presents a few examples in which children made unauthorized in-app purchases that were relatively large, some greater than \$500, and one bill as high as

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<sup>19</sup> *Unfairness Statement*, *supra* note 7, at n.12.

<sup>20</sup> *Beales’ Unfairness Speech*, *supra* note 8, § III (“relative to the benefits, the injury may still be substantial” and “[t]o qualify as substantial, an injury must be real, and it must be large compared to any offsetting benefits.”).

<sup>21</sup> *Apple Complaint*, *supra* note 1, at para. 24.

<sup>22</sup> Press Release, Apple, Inc., Apple’s App Store Marks Historic 50 Billionth Download (May 16, 2013), available at <http://www.apple.com/pr/library/2013/05/16Apples-App-Store-Marks-Historic-50-Billionth-Download.html>.

\$2,600.<sup>23</sup> There is undoubtedly consumer harm in these instances, assuming the purchases are correctly attributed to the alleged failure to disclose, but again, in order to qualify as substantial, the harm “must be large compared to any offsetting benefits.”<sup>24</sup>

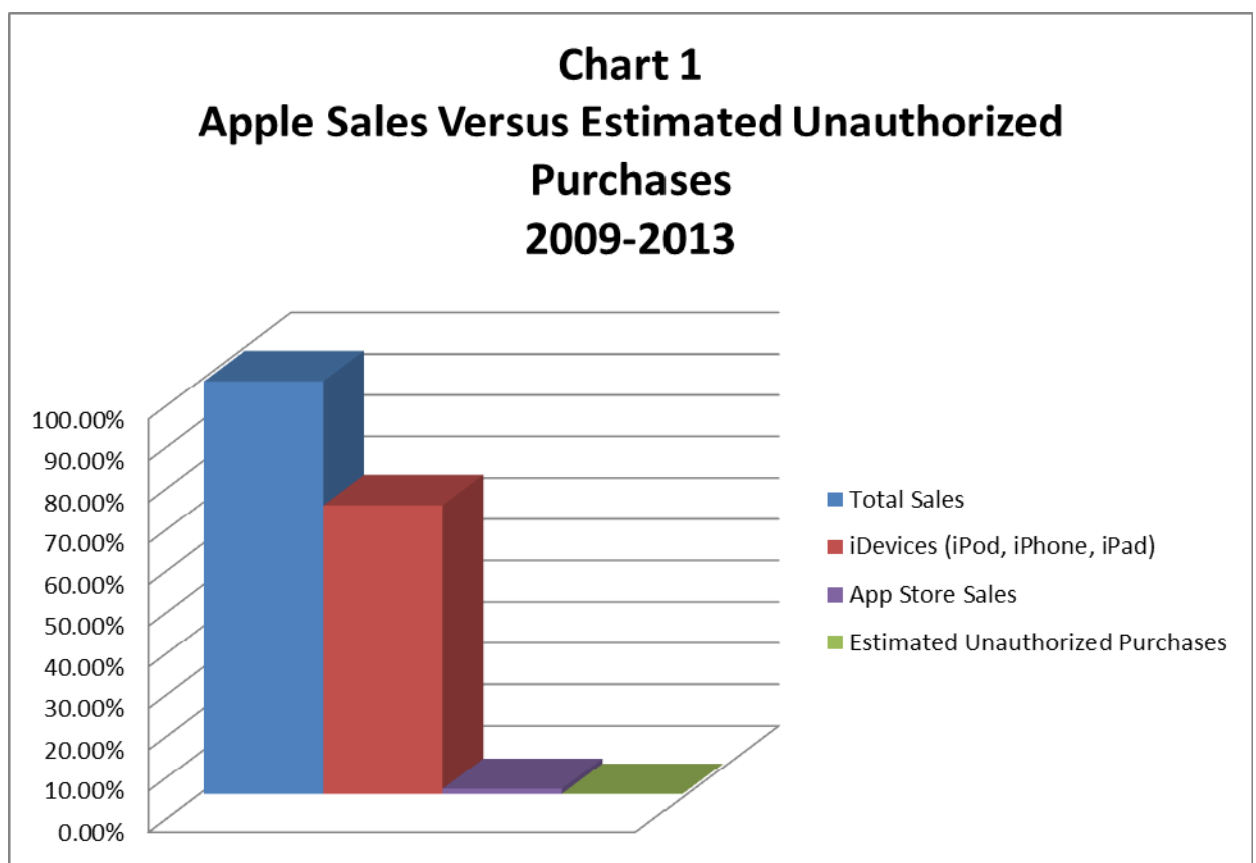
The relevant economic context required to understand substantiality of injury in this case includes the proportions of populations potentially harmed and benefitted by the failure to disclose product features in this case. A measure of harm that gives weight to both the number of consumers harmed and the size of the individual harms is the ratio of the value of unauthorized purchases to the total sales affected by the practice. We can construct such a measure as follows. The \$32.5 million in consumer refunds required by the consent decree presumably relates in some way to the harm arising from Apple’s disclosure practices. Recognizing that monetary amounts emerging from consent decrees are a product of compromise and an assessment of litigation risk, suppose that the value of unauthorized purchases is ten times higher than the negotiated settlement amount. This assumption gives a conservatively high estimate of \$325 million in unauthorized purchases since the inception of the App Store. The total sales affected by Apple’s disclosure practices likely include not only the sale of apps and in-app purchases, but also the sale of iDevices. This is likely because the benefits from using apps and making in-app purchases are components of the stream of benefits generated by iDevices, and a customer’s decision to purchase an iDevice will depend upon the stream of benefits derived from the device. Indeed, the degree of integration across all components of Apple’s platform is remarkably high, suggesting that Apple’s disclosure practices may affect all Apple’s sales. For completeness, Charts 1 and 2 below measure the estimated harm as a fraction

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<sup>23</sup> *Apple Complaint*, *supra* note 1, at para. 25-26.

of all three variants of Apple's sales – App Store sales, iDevice sales, and total sales. These data are available from Apple's Annual Reports and press releases.

Chart 1 shows that the estimated value of the harm is a miniscule fraction of both Apple total sales (about six one-hundredths of one percent) and iDevice sales (about eight one-hundredths of one percent) over the five-year period from the inception of the App Store to September 2013. This measure of harm, a conservatively high estimate, is also a relatively small fraction of App Store sales (about 4.6 percent).

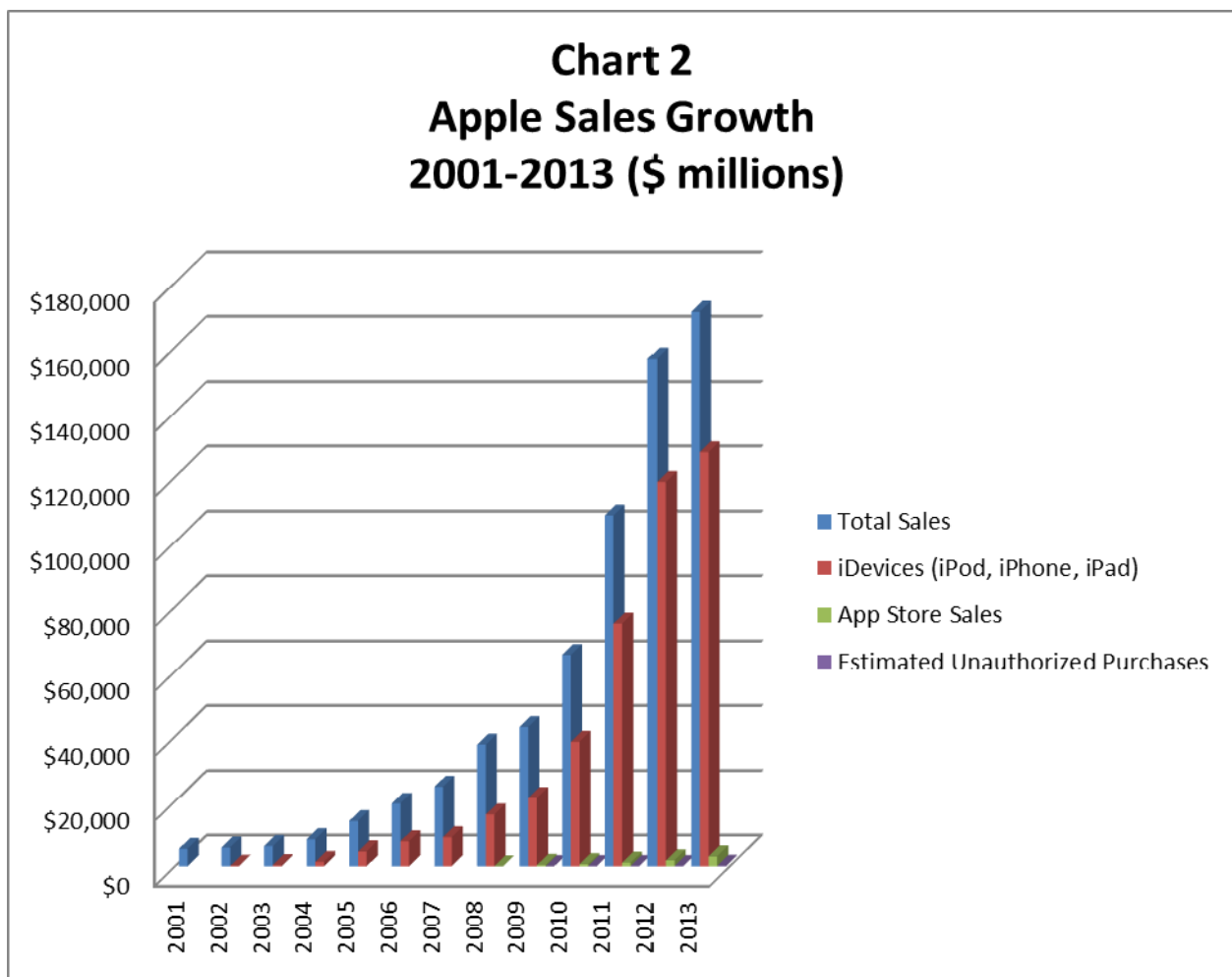


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<sup>24</sup> *Beales' Unfairness Speech*, *supra* note 8, § III.

*Sources:* Apple, Inc., Annual Reports for 2009-2013 (Form 10-K); Marin Perez, *Apple App Store A \$1.2 Billion Business In 2009*, InformationWeek, June 11, 2008, available at [http://www.informationweek.com/mobile/mobile-devices/apple-app-store-a-\\$12-billion-business-in-2009/d/d-id/1068794](http://www.informationweek.com/mobile/mobile-devices/apple-app-store-a-$12-billion-business-in-2009/d/d-id/1068794); *Apple Complaint*, *supra* note 1 (for the \$32.5 million settlement amount).

Chart 2 illustrates the same relationship with respect to Apple sales growth over the last 13 years.



*Sources:* Same as Chart 1, plus Apple, Inc., Annual Reports for 2002-2008 (Form 10-K).

Calculations assume the App Store sales and estimated unauthorized purchases grew at a constant percentage growth rate from 2009 through 2013.

Taking into account the full economic context of Apple’s choice of disclosures relating to the fifteen-minute window undermines the conclusion that any consumer injury is substantial.

## **II. At Least Some of the Injury Could Be Reasonably Avoided by Consumers**

The Unfairness Statement provides that the “injury must be one which consumers could not reasonably have avoided.”<sup>25</sup> In explaining that requirement the Commission noted, “[i]n some senses any injury can be avoided – for example, by hiring independent experts to test all products in advance, or by private legal actions for damages – but these courses may be too expensive to be practicable for individual consumers to pursue.”<sup>26</sup> The complaint does not allege that the undisclosed fifteen-minute window is an unfair practice as to any consumer other than parents of children playing games likely to be played by children that have in-app purchasing capability.<sup>27</sup> In the instant case, it is very likely that most parents were able to reasonably avoid the potential for injury, and this avoidance required nothing as drastic as hiring an independent expert, but rather common sense and a modicum of diligence.

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<sup>25</sup> *Unfairness Statement*, *supra* note 7, at 1074.

<sup>26</sup> *Unfairness Statement*, *supra* note 7, at n.19.

<sup>27</sup> Indeed, there are many financial, banking, and retail apps and websites that allow consumers to conduct a series of transactions after entering a password only once. These services usually only require re-entry of a password after a certain amount of time has elapsed, or the session expires because of inactivity on the user’s part. It is doubtful that the Commission would bring an unfairness case because these services do not disclose this window.

The harm to consumers contemplated in the complaint involves app functionality that changed over time. In the earliest timeframe, the harm occurred when a parent typed in their Apple password to download an app with in-app purchase capability, handed the Apple device to their child, and then unbeknownst to the parent, the child was able to make in-app purchases by pressing the “buy” button during the fifteen-minute window in which the password was cached. This was apparently an oversight on Apple’s part. When it came to the company’s attention, Apple implemented a password prompt for the first in-app purchase after download.<sup>28</sup>

During the later timeframe, after being handed the Apple device, a child again would press the “buy” button to make an in-app purchase. At this point, the child would have needed to turn the device back over to the parent for entry of the password. Alternatively, some children may have known their parent’s password and entered it themselves. In either case, the fifteen-minute window was opened and additional in-app purchases could be made without further password prompts.

Under the first scenario, account holders received no password prompt for the first in-app purchase and thus the injury experienced by some consumers arguably may not have been reasonably avoidable. Because the opening of the fifteen-minute window *in this context* does not appear to be a product design feature, but rather an unintended oversight, I will focus my attention upon the harm experienced by consumers in the latter scenario and discuss their ability to reasonably avoid it.

Irrespective of the existence of the fifteen-minute window, a user can only make an in-app purchase by pressing a “buy” button while engaging with the app. In other words, the user

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<sup>28</sup> See Foresman, *supra* note 13.



must decide to make an in-app purchase. To execute the first in-app purchase, the user must enter a password. The fifteen-minute window eliminates the second step of verification – entering a password – only *after* the user has made the first in-app purchase by clicking the “buy” button and entering the password.

By entering their password into the Apple device – an action that is performed in response to a request for permission – parents were effectively put on notice that they were authorizing a transaction.<sup>29</sup> Although the complaint alleges that the fifteen-minute window was not expressly disclosed to parents, regular users of Apple’s platform become familiar with the opportunity to make purchases without entering a password every time.<sup>30</sup> Even if some parents were not familiar with the fifteen-minute window, the requirement to re-enter their password to authorize a transaction arguably triggered some obligation for them to investigate further, rather than just to hand the device back to the child without further inquiry.<sup>31</sup>

### **III. Any Consumer Injury Caused by Apple’s Platform is Outweighed by Countervailing Benefits to Consumers and Competition**

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<sup>29</sup> Furthermore, Apple sends an email receipt to the iTunes account holder after a purchase has been made in either the iTunes or App Store. See e.g., <http://www.apple.com/privacy/>.

<sup>30</sup> To the extent that users read the Apple Terms and Conditions when they opened their iTunes accounts, consumer injury would also have been avoided. The Terms and Conditions explain the fifteen-minute window and other aspects of how Apple’s platform works, including the App Store. It appears that Apple has included these explanations since at least June 2011. See <http://www.apple.com/legal/internet-services/itunes/us/terms.html#SALE> (Apple’s current Terms and Conditions) and <http://www.proandcontracts.com/wp-content/uploads/2011/06/2011.06.09-iTunes-Terms-and-Conditions-June-2011-Update-with-Highlighting.pdf> (cached copy of what appears to be its Terms and Conditions as of June 2011).

<sup>31</sup> The Terms and Conditions also explain how to use the parental control settings to control how the App Store works. See <http://support.apple.com/kb/HT1904> and <http://support.apple.com/kb/HT4213>. These parental control settings allow users to disable in-app purchasing capability as well as establish settings that require a password each time a purchase is made, thereby eliminating the fifteen-minute window.

Assuming for the moment there is at least some harm that consumers cannot reasonably avoid, the question turns to whether the harms are substantial relative to any benefits to competition or consumers attributable to the conduct. In performing this balancing, the Commission must also take “account of the various costs that a remedy would entail. These include not only the costs to the parties directly before the agency, but also the burdens on society in general in the form of increased paperwork, increased regulatory burdens on the flow of information, reduced incentives to innovation and capital formation, and similar matters.”<sup>32</sup> I now turn to that question.

#### ***A. Apple’s Platform as a Benefit to Consumers and Competition***

Unfairness analysis requires an evaluation and comparison of the benefits and costs of Apple’s decision not to increase or enhance its disclosure of how Apple’s platform works, including the fifteen-minute window. The fifteen-minute window is a *feature* of Apple’s platform that applies to purchases of songs, books, apps, and in-app purchases. This feature has long been a part of the iTunes Store for downloading music, and regular users of iTunes apparently value it. In the context here, disclosure is perhaps better thought of as a product attribute—*guidance*—that Apple provides to the customer through on-screen and other explanations of how to use Apple’s platform.<sup>33</sup>

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<sup>32</sup> *Unfairness Statement*, *supra* note 7, at 1073-74.

<sup>33</sup> Compare the disclosure contemplated here with disclosure in the mortgage context, for example. Here, the disclosure itself – or the guidance offered while the user is interacting with the product – is an intrinsic part of the product’s value. Indeed, Apple’s business model is built on offering an integrated platform with a clean design that customers find intuitive and easy to use. The way the platform is presented, including disclosures or guidance offered during use, is a critically important component of value. In the mortgage context, the disclosures signed at closing are not a significant component of the value of the mortgage.

In deciding what guidance to provide and how to provide it, firms face two important issues. First, since it is generally not possible to customize guidance for every individual customer, the optimal guidance inevitably balances the needs of different customers. In drawing this balance, the potential for harm from misinterpretation is likely important in deciding which customer on the sophistication spectrum might represent the least common denominator for directing the guidance. For any given degree of guidance, some customers will get it immediately, while others will have to work harder. If the potential for harm is very large, e.g., harm from a drug overdose, then both the firm and consumers want obvious, strong disclosures about dosage, and perhaps other steps like childproof caps. If the potential for harm is small, then strong guidance (or caps that are hard to open in the drug context) may make it more costly for consumers to use the product. Platform designers clearly face such tradeoffs in their decision-making regarding guidance and disclosures. Apple clearly faces the same tradeoff with respect to its decisions concerning the fifteen-minute window. This tradeoff is relevant for evaluating the benefit-cost test at the core of unfairness analysis.

Second, because it is difficult to anticipate the full set of issues that might benefit from guidance of various types, the firm must decide how much time to spend researching, discovering, and potentially fixing possible issues *ex ante* versus finding and fixing issues as they arise. With complex technology products such as computing platforms, firms generally find and address numerous problems as experience is gained with the product. Virtually all software evolves this way, for example. This tradeoff—between time spent perfecting a platform up front versus solving problems as they arise—is also relevant for evaluating unfairness.

Apple presumably weighs the costs and benefits to Apple of different ways to provide guidance. In doing so, Apple must consider: (i) the benefit to Apple of greater sales of mobile

devices, music, books, apps, and in-app components to customers who benefit from the additional guidance and make more purchases; (ii) the cost to Apple of fewer sales of mobile devices, music, books, apps, and in-app components by customers who find that more real-time guidance hampers their experience; and (iii) the cost to Apple of developing and implementing more guidance. In weighing (i) and (ii), Apple is particularly concerned about the effects on the sales of mobile devices that use Apple's platform, as they constitute the bulk of Apple's business, as indicated in Charts 1 and 2.<sup>34</sup>

The relevant universe for assessing unfairness of Apple's guidance provision, including disclosures relating to the fifteen-minute window, is the set of users to whom the guidance is directed. This includes all users of Apple's platform who might make online purchases through the platform.

The ratio of estimated unauthorized purchases in this case to all purchases made by users of Apple's platform is miniscule, as Charts 1 and 2 illustrate. This fact, by itself, does not establish that the benefits of Apple's decision to forgo additional guidance of the type required by the consent order outweigh its costs. However, the remarkably low ratio does provide perspective on the following question: How much would the average non-cancelling customer need to be harmed by a requirement of additional guidance in order to outweigh the benefit of preventing harm to other consumers? Suppose the fraction of customers that would benefit from additional guidance is approximated by the ratio of estimated unauthorized purchases to total sales of iDevices. The analysis in Charts 1 and 2 indicates that estimated unauthorized purchases

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<sup>34</sup> In 2012, sales of the iPhone, iPad, and iPod accounted for over 76 percent of Apple's \$157 billion in sales. *See* Apple, Inc., Annual Report (Form 10-K), at 73 (Oct. 31, 2012), *available at* <http://files.shareholder.com/downloads/AAPL/2661211346x0xS1193125-12-444068/320193/filing.pdf>.

have been about 0.08 percent of iDevice-related sales since the App Store was launched. Suppose that customers that make unauthorized purchases cancel them and seek a refund. Suppose also that the time cost involved in seeking a refund return is \$11.95.<sup>35</sup> Then, if the average harm to non-cancelling customers from additional guidance sufficient to prevent cancellations is more than about a penny per transaction, the additional guidance will be counter-productive.<sup>36</sup>

To be clear, the sales of iDevices are not an estimate of consumer benefits but rather they approximate the total universe of economic activity implicated by the Commission's consent order. Similarly, estimated unauthorized purchases merely approximate the total universe of consumers potentially harmed by Apple's practices. The harm from Apple's disclosure policy is limited to users that actually make unauthorized purchases. However, the potential benefits from Apple's disclosure choices are available to the entire set of iDevice users because these are the consumers capable of purchasing apps and making in-app purchases. The disparity in the relative magnitudes of these universes of potential harms and benefits suggests, at a minimum, that further analysis is required before the Commission can conclude that it has satisfied its

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<sup>35</sup> The \$11.95 figure represents the seasonally adjusted average earnings per half hour across all employees on private nonfarm payrolls, as reported by the Bureau of Labor and Statistics in May 2013. See <http://www.bls.gov/news.release/empsit.t19.htm> for the most recent report. The assumption is that customers that asked for returns were reimbursed for the charges as Apple attests, and that obtaining a reimbursement takes half an hour.

<sup>36</sup> Let Y be the harm to non-cancelling customers from additional guidance sufficient to prevent cancellations. This harm will just equal the benefit of avoiding cancellations if  $(\% \text{ Cancelling}) \times (\text{Refund Time Cost}) - (\% \text{ Not Cancelling}) \times Y = 0$ . Assuming  $(\% \text{ Cancelling})$  is .0008,  $(\text{Refund Time Cost})$  is \$11.95, and  $(\% \text{ Not Cancelling})$  is .9992, solving for Y gives  $Y = \$0.009$ . In other words, if the harm to non-cancelling customers from additional guidance is more than roughly one cent for each transaction, then the costs of the additional guidance will outweigh the benefits.

burden of demonstrating that any consumer injury arising from Apple’s allegedly unfair acts or practices exceeds the countervailing benefits to consumers and competition.<sup>37</sup>

Nonetheless, the Commission effectively rejects an analysis of tradeoffs between the benefits of additional guidance and potential harm to some consumers or to competition from mandating guidance by assuming that “the burden, if any, to users who have never had unauthorized charges for in-app purchases, or to Apple, from the provision of this additional information is *de minimis*” and that any mandated disclosure would not “detract in any material way from a streamlined and seamless user experience.” I respectfully disagree. These assumptions adopt too cramped a view of consumer benefits under the Unfairness Statement and, without more rigorous analysis to justify their application, are insufficient to establish the Commission’s burden.

***B. The Costs and Benefits to Consumers and Competition of Apple’s Product  
Design and Disclosure Choices***

To justify a finding of unfairness, the Commission must demonstrate the allegedly unlawful conduct results in net consumer injury. This requirement, in turn, logically implies the Commission must demonstrate Apple’s chosen levels of guidance are less than optimal because consumers would benefit from additional disclosure. There is a considerable economic literature

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<sup>37</sup> Commissioner Ohlhausen suggests that our unfairness analysis compares inappropriately the injury caused by Apple’s lack of clear disclosure with the benefits of Apple’s disclosure policy to the entire ecosystem. She argues that this approach “skew[s] the balancing test for unfairness and improperly compare[s] injury ‘oranges’ from an individual practice with overall ‘Apple’ ecosystem benefits.” Statement of Commissioner Ohlhausen at 3. For the reasons discussed, this analysis misses the point.

on this subject that sheds light upon the conditions under which one might reasonably expect private disclosure levels to result in net consumer harm.<sup>38</sup>

To support the complaint and consent order the Commission issues today requires evidence sufficient to support a reason to believe that Apple will undersupply guidance about its platform relative to the socially optimal level. Economic theory teaches that such a showing would require evidence that “marginal” customers – the marginal consumer is the customer that is just indifferent between making the purchase or not at the current price – would benefit *less* from the consent order than the “inframarginal” customers who are willing to pay significantly more for the product than the current price and therefore would purchase the product irrespective of a small adjustment in an attribute. Nobel Laureate Michael Spence points out in his seminal work on the subject that this analysis generally requires information on the valuations of inframarginal consumers.<sup>39</sup> Here, marginal consumers are those who would not have made in-app purchases if Apple would have disclosed the fifteen-minute window. Inframarginal consumers are those Apple customers who would not change their purchasing behavior in response to a change in Apple’s disclosures.

Staff has not conducted a survey or any other analysis that might ascertain the effects of the consent order upon consumers. The Commission should not support a case that alleges that Apple has underprovided disclosure without establishing this through rigorous analysis demonstrating – whether qualitatively or quantitatively – that the costs to consumers from

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<sup>38</sup> Disclosure in this context is analogous to a quality decision that may affect different customers differently. A. Michael Spence, *Monopoly, Quality and Regulation*, 6 BELL J. OF ECON. 417-29 (1975); Eytan Sheshinski, *Price, Quality and Quantity Regulation in Monopoly Situations*, 43 ECONOMICA 127-37 (1976). The analysis of this issue is also explained in JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* § 2.2.1 (MIT Press 1988).

Apple’s disclosure decisions have outweighed benefits to consumers and the competitive process. The absence of this sort of rigorous analysis is made more troublesome in the context of a platform with countless product attributes and where significant consumer benefits are intuitively obvious and borne out by data available to the Commission. We cannot say with certainty whether the average consumer would benefit more or less than the marginal consumer from additional disclosure without empirical evidence. This evidence might come from a study of how customers react to different disclosures. However, given the likelihood that the average benefit of more disclosure to unaffected customers is less than the benefit to affected customers who are likely to be customers closer to the margin, I am inclined to believe that Apple has more than enough incentive to disclose.<sup>40</sup>

***C. Other Considerations When Examining the Costs and Benefits of Platforms  
and other Multi-Attribute Products***

Unfairness analysis also requires the Commission to consider the impact of contemplated remedies or changes in the incentives to innovate new product features upon consumers and competition.<sup>41</sup> I close by discussing some additional dimensions of an economic analysis of the costs and benefits of product disclosures in the context of complicated products and platforms

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<sup>39</sup> Spence, *supra* note 38.

<sup>40</sup> This argument does not, as Chairwoman Ramirez and Commissioner Brill suggest, “*presuppose* that a sufficient number of Apple customers will respond to the lack of adequate information by leaving Apple for other companies.” Statement of Chairwoman Ramirez and Commissioner Brill at 5-6. Nor does the economic logic require any belief about the magnitude of switching costs. Rather, the analysis relies only upon the standard economic assumption that Apple chooses disclosure to maximize shareholder value, weighing how customers react to different disclosure policies. If Apple behaves this way, the average benefit of more disclosure to unaffected customers is less than the benefit to affected customers, and affected customers are more likely to be on the margin than unaffected customers, then economic theory implies that Apple is likely to have more than enough incentive to disclose.



with many attributes, like Apple’s platform, where such disclosures are a critical component of the user experience and have considerable impact upon the value consumers derive from the product.

For complicated products – for example, a web-based platform for purchasing and interacting with potentially millions of items using a mobile device – there are many things that can negatively impact user experience. The number of potential issues for products that involve hardware, software, and a human interface is large. This is the nature of technology. When designing a complex product, it is prohibitively costly to try to anticipate *all* the things that might go wrong. Indeed, it is very likely impossible. Even when potential problems are found, it is sometimes hard to come up with solutions that that one can be confident will fix the problem. Sometimes proposed solutions make it worse. In deciding how to allocate its scarce resources, the creator of a complex product weighs the tradeoffs between (i) researching and testing to identify and determine whether to fix potential problems in advance, versus (ii) waiting to see what problems arise after the product hits the marketplace and issuing desirable fixes on an ongoing basis. We observe the latter strategy in action for virtually all software.

The relevant analysis of benefits and costs for allegedly unfair omissions requires weighing of the benefits and costs of discovering and fixing the issue that arose *in advance* versus the benefits and costs of finding the problem and fixing it *ex post*. These considerations fit comfortably within the unfairness framework laid out by the Commission.<sup>42</sup> The Commission also takes account of the various costs that a remedy would entail. These include not only the

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<sup>41</sup> *Unfairness Statement*, *supra* note 7, at 1073-74.

costs to the parties directly before the agency, but also the burdens on society in general in the form of increased regulatory burdens on the flow of information, reduced incentives to innovate and invest capital, and other social costs.<sup>43</sup>

Here, Apple did not anticipate the problems customers would have with children making in-app purchases that parents did not expect. When the problem arose in late 2010, press reports indicate that Apple developed a strategy for addressing the problem in a way that it believed made sense, and it also refunded customers that reported unintended purchases.<sup>44</sup> This is precisely the efficient strategy described above when complex products like Apple’s platform develop problems that are difficult to anticipate and fix in advance. Establishing that it is “unfair” unless a firm anticipates and fixes such problems in advance – precisely what the Commission’s complaint and consent order establishes today – is likely to impose significant costs in the context of complicated products with countless product attributes. These costs will be passed on to consumers and threaten consumer harm that is likely to dwarf the magnitude of consumer injury contemplated by the complaint.

This investigation began largely because of complaints that arose when in-app purchases were first introduced into the marketplace and Apple had not had enough experience with the platform to recognize how parents and children would use the App Store. In late 2010, complaints began to emerge. In March 2011, Apple first altered its platform to address complaints about unauthorized in-app purchases. It is not unreasonable to surmise that as Apple

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<sup>42</sup> The Commission must take “account of the various costs that a remedy would entail” including “reduced incentives to innovation and capital formation, and similar matters.” *Unfairness Statement*, *supra* note 7, at 1073-74.

<sup>43</sup> *Unfairness Statement*, *supra* note 7, at 1073-74.

<sup>44</sup> *See* Foresman, *supra* note 13.

has modified its policies based on experience, and customers have learned more about how to use the platform, unauthorized in-app purchases by children have most likely steadily declined.

The Commission has no foundation upon which to base a reasonable belief that consumers would be made better off if Apple modified its disclosures to confirm to the parameters of the consent order. Given the absence of such evidence, enforcement action here is neither warranted nor in consumers' best interest.

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